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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 727

FREDERICK K. BARBOUR,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

CHARLES S. MCVEIGH,
GEORGE M. WOLFSON,
Attorneys for Petitioner.

Pandick Press, Inc., 22 Thames St., New York, U. S. A.

INDEX.

TABLE OF CONTENTS.

	PAGE
Opinions below	2
Jurisdiction	2
Questions presented	2
Statutes involved	3
Statement	3
Specification of errors	7
Reasons for granting the writ	8
Conclusion	15
Appendix	16

TABLE OF CASES.

Commissioner v. *Berolzheimer*, 116 F. (2d) 628 (C. C. A. 2)	11
Commissioner v. *Branch*, 114 F. (2d) 985 (C. C. A. 1)	5, 12
Commissioner v. *Brown*, (C. C. A. 3), Sept. 4, 1941 (C. C. H. 1941 Fed. Tax Service, Vol. 4, p. 10, 569)	12, 14
Commissioner v. *Buck*, 120 F. (2d) 775 (C. C. A. 2)	11
Commissioner v. *Central National Bank*, 119 F. (2d) 470 (C. C. A. 6)	14
Commissioner v. *Chamberlain*, 121 F. (2d) 765 (C. C. A. 2)	11
Commissioner v. *Jonas*, 122 F. (2d) 169 (C. C. A. 2)	11
Commissioner v. *O'Keeffe*, 118 F. (2d) 639 (C. C. A. 1)	14
Commissioner v. *Ward*, 119 F. (2d) 207 (C. C. A. 3)	14

PAGE

Commissioner v. *Woolley*, 122 F. (2d) 167 (C. C. A. 2) 11
Cox v. *Commissioner*, 110 F. (2d) 934 (C. C. A. 10)..... 12
Crabb v. *Commissioner*, 121 F. (2d) 1015 (C. C. A. 5) 14

First National Bank v. *Commissioner*, 110 F. (2d) 448 (C. C. A. 7)..... 12

Helvering v. *Achelis*, 112 F. (2d) 929 (C. C. A. 2)..... 11
Helvering v. *Clifford*, 309 U. S. 331.....7, 8, 9, 10, 11, 12, 13
Helvering v. *Elias*, 122 F. (2d) 171 (C. C. A. 2)..... 11
Helvering v. *Richter*, 312 U. S. 561.....7, 8, 13
Helvering v. *Wood*, 309 U. S. 344..... 6
Hormel v. *Helvering*, 312 U. S. 552.....7, 8, 10, 11, 12, 13

Jones v. *Norris*, 112 F. (2d) 6 (C. C. A. 10)..... 12

Reuter v. *Commissioner*, 118 F. (2d) 698 (C. C. A. 5) 12
Richardson v. *Commissioner*, 121 F. (2d) 1 (C. C. A. 2) 11

White v. *Higgins*, 116 F. (2d) 312 (C. C. A. 1)..... 12
Whiteley v. *Commissioner*, 120 F. (2d) 782 (C. C. A. 3) 12

STATUTES.

Judicial Code, Sec. 240 (a)..... 2

Revenue Act of 1934:

Sec. 22 (a) 2, 3, 7, 13, 16
Sec. 166 .....3, 6, 12, 16
Sec. 167 .....3, 6, 7, 15, 16

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States:

Petitioner, Frederick K. Barbour, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered in this cause on August 12, 1941, reversing the decision of the United States Board of Tax Appeals, and remanding the proceedings to said Board with instructions to determine the deficiency to be paid by petitioner in accordance with the views expressed in the opinion of said Court.

Opinions Below.

The opinions of the Board of Tax Appeals are reported at 39 B.T.A. 910 and will be found in the Record (pp. 149 to 158).

The opinion of the Circuit Court of Appeals is reported in 122 F. (2d) 165 (Adv. Sh. Sept. 29, 1941) and is appended to the Record.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered August 12, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

Securities were transferred by petitioner to independent trustees in trust to pay the income to the petitioner's wife, children and mother-in-law in set proportions, the trusts terminating after a period of years or the prior death of petitioner or his wife. No powers of management or control were retained by petitioner or given to any member of his family, all such powers being vested in the independent trustees. On the termination of the trusts the corpus was to be transferred to the petitioner if living or otherwise as appointed in his will, or in the absence of will to his surviving children or heirs. The questions presented are:

(1) Whether the income from the trusts during the years 1934 and 1935 is taxable to the petitioner under Section 22 (a) of the Revenue Act of 1934;

(2) In particular, whether that portion of the income which was payable to Gertrude C. Carrere, petitioner's

mother-in-law, who did not reside with petitioner nor form part of his household, is so taxable;

(3) Whether the court below should have remanded the case to the Board of Tax Appeals to receive evidence and consider the applicability of said Section 22 (a) to this case;

(4) Whether (if the first question is answered favorably to petitioner) the amount of a premium payment made by petitioner's wife on a life insurance policy on her husband's life owned by her constitutes taxable income of the petitioner under Section 167 of said Revenue Act.

Statutes Involved.

The statutes involved are Sections 22 (a), 166 and 167 of the Revenue Act of 1934 and will be found in the appendix *infra* (pp. 16, 17).

Statement.

All of the facts as found by the Board (R. 150, *et seq.*) were set forth in two stipulations and exhibits attached thereto (R. 26 to 148).

The petitioner during the taxable years was, and now is, a resident of Norfolk, Connecticut (R. 150, 82, 88). On October 29, 1931 he executed a deed of trust (R. 33-50) whereby he conveyed to Lewis Spencer Morris and Charles S. McVeigh, of New York City, as trustees, securities of various corporations. No power to revoke or change the terms of the trust, or exercise any control over the trust property or its management was reserved by the petitioner or given to any member of his family. The trustees were given full control over the corpus of the trust (R. 37-44) and were directed to pay its net income in monthly or quarterly instalments as follows (R. 34, 150):

Four-tenths to the petitioner's wife, Helen Carrere Barbour;
One-tenth to each of three minor children, and
Three-tenths to the mother of petitioner's wife, a resident during the taxable years until her death on November 15, 1935, of Rumson, New Jersey (R. 124, 126).

The trust by its terms was to terminate on December 31, 1932 or upon the prior death of the grantor or his wife (R. 35, 36, 150). By successive instruments made March 11, 1932 (R. 51) and December 15, 1934 (R. 53) the life of the trust was first extended until December 31, 1935 and thereafter until December 31, 1940 (R. 151). On the termination of the trust the corpus was to revert to petitioner if living and otherwise was to be transferred as might be appointed in his will or in the absence of will to his surviving children or their heirs, executors, administrators and assigns (R. 36, 151).

On November 20, 1934 the petitioner executed a second deed of trust (R. 57) to the same trustees for the same beneficiaries in like proportions and upon terms substantially identical with those provided in the first trust. The corpus of the second trust was increased on December 15, 1934 by adding securities thereto, and on the same day the expiration date of December 31, 1939 was extended to December 31, 1940, thus making the expiration dates of both trusts the same (R. 72, 76, 151).

The trustees in both trusts were attorneys at law constituting the partnership of Morris & McVeigh, 60 Wall Street, New York City (R. 91, 99). Mr. McVeigh was and is the personal attorney of the petitioner. Mr. Morris is Chairman of the Board of the Fulton Trust Company of New York (R. 96, 104). The extensive powers of management and control of the trust property given to these trus-

tees are substantially identical in both instruments of trust (Exs. 1, 4, R. 33, 57), and will be found enumerated in Exhibit 1 (R. 37 to 44).*

The trustees were entitled to substantial commissions (R. 45, 69) and actually received them (R. 80, 84, 86). In case of a vacancy (which never occurred) the petitioner was given power to appoint a successor trustee (R. 44, 68).

It was further found by the Board that none of the trust income was used for the maintenance and support of petitioner's wife or children or to discharge his legal obligations, and that none of the trust income was paid to petitioner (R. 28, 29, 152). The beneficiaries of the trusts actually received the income payable to them, filed income tax returns in respect thereof and paid the taxes (R. 28 to 30).

There is no evidence to indicate that Mrs. Carrere, the mother of petitioner's wife to whom three-tenths of the income of the trust was payable, was dependent upon petitioner or constituted a member of his household, and as pointed out by the court below "she did not live in the household or even in the same town as the grantor" (122 F. (2d) at p. 167; R. 124, 126).

In response to petitioner's request for a ruling, the Bureau of Internal Revenue advised on November 27, 1934 that the creation of the second deed of trust constituted a taxable gift under the gift tax law of a present interest to each donee of an amount equivalent to the value of the interest in the income given to each donee for the life of the trust (R. 142). Following receipt of such advice and on December 15, 1934 petitioner added securities to the

* The securities in the first trust were transferred subject to a lien for an existing bank loan of $100,000 (R. 38) and the trustees were given authority to assume payment of the loan. This circumstance would appear to be without importance (see *Commissioner* v. *Branch*, 114 F. (2d) 985, 987, 988 (C. C. A. 1)).

second deed of trust and extended the life of the first and second deeds of trust to December 31, 1940 (R. 53, 72, 76). Pursuant to the ruling of the Bureau petitioner filed his gift tax return for the calendar year 1934 and paid the tax resulting therefrom, which, as adjusted, amounted to $26,229.56 (R. 31).

It further appears that Mrs. Barbour owned a life insurance policy on petitioner's life and on February 19, 1935 paid the first premium thereon (R. 30, 94, 153) with funds presumably received in whole or in part from the trusts. Such payment was not, however, made pursuant to any provision of the trust instruments or any agreement, nor did it constitute the application of any part of the trust income as such to the payment of the premium (R. 154).

None of the income from the trusts was reported by petitioner in his income tax returns for the years 1934 and 1935. The Commissioner determined that such income, amounting to $92,821.54 in 1934 and $131,455.67 in 1935, was taxable to the petitioner under Section 166 of the Revenue Act of 1934 (App. p. 16) and applicable Treasury regulations on the theory that this term trust was a revocable trust within the purview of that section (R. 16, 20, 28, 29).

Before the Board of Tax Appeals the Commissioner maintained this position under Section 166 and further claimed that in the alternative the amount of $5,208 used to pay the aforesaid premium of life insurance was taxable to the petitioner under Section 167 of the Revenue Act (App. pp. 16, 17). The Board of Tax Appeals decided both questions against the Commissioner (R. 152-157).

On appeal to the Circuit Court of Appeals the Commissioner specifically, in his brief and in oral argument, abandoned all contention under Section 166 in view of the decision of this Court in *Helvering* v. *Wood,* 309 U. S. 344, and took the position that all of the trust income is taxable to

petitioner as "gross income" under Section 22 (a) of the Revenue Act of 1934 (App. p. 16). The Commissioner also maintained his position as to the taxability of the aforesaid $5,208 under Section 167 (a) (3). In view of the decisions of this Court in *Hormel* v. *Helvering,* 312 U. S. 552, and *Helvering* v. *Richter,* 312 U. S. 561, the Circuit Court of Appeals permitted respondent to urge the applicability to these trusts of Section 22 (a), although the point was not urged before the Board. The court held that under Section 22 (a) and the decision of this Court in *Helvering* v. *Clifford,* 309 U. S. 331, all income from the trusts during the taxable years is taxable to petitioner. The question relating to the insurance premium was left undetermined. The court below reversed the order of the Board and remanded the proceedings with instructions to compute the income taxable to petitioner and determine the deficiency in accordance with the views expressed in its opinion.

Specification of Errors.

The Circuit Court of Appeals erred:

1. In holding that the trust income is taxable to petitioner under Section 22 (a) of the Revenue Act of 1934;

2. In any event, in holding that the portion of such trust income payable to Gertrude C. Carrere is so taxable;

3. In reversing the decision of the Board of Tax Appeals;

4. In any event, in failing to direct a rehearing by the Board of Tax Appeals for the reception and consideration of evidence directed to the applicability of Section 22 (a) to the tax liability of petitioner in respect of the trust income;

5. In any event, in failing to direct such rehearing in respect of the portion of the trust income payable to Gertrude C. Carrere.

Reasons for Granting the Writ.

It is submitted that the decision of the court below is in conflict with the decisions of this Court in *Helvering* v. *Clifford,* 309 U. S. 331, and *Hormel* v. *Helvering,* 312 U. S. 552, in that the income from the trusts was held taxable to the grantor notwithstanding that neither the grantor nor any member of his family were trustees nor retained or were given any control over or powers of management with respect to the trust property; that as a result of the decision below and other recent decisions by circuit courts of appeals, there is confusion and uncertainty, which this Court should resolve, in the application of the rule of the *Clifford* case with respect to the effect to be given (a) to the grantor's reserved powers of control and management (or the lack thereof), (b) to the duration of the trust and (c) to the relationship of the grantor to beneficiaries who are neither closely related to him nor form part of his household; that the decision below is in conflict with the decisions of this Court in *Hormel* v. *Helvering, supra,* and *Helvering* v. *Richter,* 312 U. S. 561, and is a departure from the appellate practice therein set forth, in that it failed to direct a rehearing before the Board of Tax Appeals upon a point not litigated by the Board but raised for the first time in the Circuit Court of Appeals, and that such departure has given rise to a conflict between the circuits.

The Circuit Court of Appeals adopted respondent's contention that the basic factors rendering the trust income taxable to petitioner were the short duration of the trusts, the fact that the beneficiaries were members of petitioner's

family and that there was a reverter to the grantor, his appointees or his children. Petitioner's contention that the essential factor of reserved management and control over the trust property was lacking in this case was met by stating that the trustees were the lawyers of grantor and that it was reasonable to suppose that he felt confident they would observe his reasonable wishes as to investment and management. The court while adverting to the fact that the grantor could neither remove the trustees, determine investments nor revoke the trusts, nevertheless felt that the trusts came within the reasoning of *Helvering* v. *Clifford* and so were taxable to the grantor (122 F. (2d) at p. 167).

The court below has gone far beyond the principles stated by this Court in the *Clifford* case. In the opinion in that case Mr. Justice Douglas recites at great length and in detail the powers which Clifford as grantor-trustee retained (pp. 332, 333) and points out that so far as his dominion and control were concerned the trust did not affect any substantial change, that in substance his control over the corpus was in all essential respects the same after the trust was created as before and that the wide powers which he retained included for all practical purposes most of the control which he as an individual would have (p. 335). These statements must be considered as of great importance in formulating the conclusion of the Court contained in the following language:

> "Rather, the short duration of the trust, the fact that the wife was the beneficiary, *and the retention of control over the corpus by respondent* all lead irresistibly to the conclusion that the respondent continued to be the owner for purposes of § 22(a)" (p. 335; italics ours).

In other places in the opinion reference is made to Clifford's "control over the investment" and to "retention by him

of control over the principal" (pp. 335, 336). Such control certainly was considered by this Court as one of the vital elements of "the bundle of rights which he retained" (p. 337).

The importance of this element in reaching the decision in the *Clifford* case is borne out by *Hormel* v. *Helvering,* 312 U. S. 552, where contention had been made by the taxpayer that although the grantor was a trustee his powers were shared by an independent co-trustee. The beneficiaries of the Hormel trusts were Hormel's minor children. Mr. Justice Black's opinion in the *Hormel* case states:

> "Here, as there, control over the trusts was completely in the hands of the taxpayer and his wife. For while petitioner's trust instruments showed a co-trustee acting with the petitioner, the same instruments also disclosed that such co-trustee could be removed at any time by the joint action of petitioner and his wife" (p. 559).

Thus, this Court in the *Hormel* case, having considered the family relationship, the short term of the trusts *and the retained control over the trust property and the co-trustee possessed by Mr. Hormel and his wife,* concluded that the principles of the *Clifford* case were applicable to those trusts.

In the case at bar the court below reached the same result for the reason that the trustees were the lawyers of the grantor. The same reasoning would apply to the choice of a bank or trust company as trustee, for it might be argued that such an institution would be equally amenable to his wishes. This reasoning does not give due weight to the fact that a prudent person in picking a trustee will naturally select some one whom he knows well or in whom

he has confidence, and will not select a stranger at random. The philosophy embodied in the decision below would result in holding that a grantor retains control over the trust property if he names any trustee with whom he is on terms of friendship or confidence or with whom he has or may have had satisfactory business relations. We do not believe that this Court in the *Clifford* and in the *Hormel* cases intended to indicate so sweeping an application of the meaning of the word "control" as would result from the adoption of the rule suggested by the court below.

As another ground for its decision the court below relies upon a dictum of Judge Frank in *Commissioner* v. *Buck*, 120 F. (2d) 775, 778 (C. C. A. 2), decided June 6, 1941, that the control factor is sufficiently present where there is a reversion and the trust is of short duration. In the *Buck* case the court also held, conversely, that if the trust is of long duration the donor would be regarded as the owner for purposes of taxation only where he *expressly* reserves substantial control of the disposition of the income.

The confusion resulting from this interpretation of the *Clifford* case is illustrated by the decisions of the same court in *Commissioner* v. *Jonas*, 122 F. (2d) 169, decided July 31, 1941, where the taxpayer was upheld in respect of a ten-year trust for the benefit of adult sons, no control being reserved by the grantor, and in *Helvering* v. *Elias*, 122 F. (2d) 171, August 1, 1941, where it was held that reserved powers of management would not be considered a necessary factor in taxing the grantor upon the income of trusts of from six to seven years but would be considered a necessary factor in trusts lasting ten years or more.*

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* See also the following decisions by the court below: *Commissioner* v. *Woolley*, 122 F. (2d) 167, July 30, 1941; *Richardson* v. *Commissioner*, 121 F. (2d) 1, July 9, 1941; *Commissioner* v. *Berolzheimer*, 116 F. (2d) 628. *Cf. Commissioner* v. *Chamberlain*, 121 F. (2d) 765, July 22, 1941; *Helvering* v. *Achelis*, 112 F. (2d) 929.

The rule sought to be formulated in the last cited cases with respect to the duration of trusts in relation to the factor of retained control has led or will lead to inevitable conflict between the circuits.*

In any case, we submit that the court below committed error with respect to the three-tenths of the income payable to Gertrude C. Carrere, the mother of petitioner's wife. As stated above, it does not appear that she was dependent upon petitioner, and the court below finds that she did not live in petitioner's household or even in the same town. In the *Clifford* case the "intimate family group" consisted of Mr. Clifford and his wife, and in the *Hormel* case the intimate family group consisted of Mr. Hormel, his wife and minor children. Nevertheless, the court below held that the burden was on the taxpayer to show that the Commissioner was wrong in so treating Mrs. Carrere and that the taxpayer made no attempt to overcome it (122 F. (2d) at 167). Such ruling does not take account of the nature of the trial which took place before the Board. In that trial Mrs. Carrere's relationship to the taxpayer was of no importance as the Government was seeking to impose liability upon the taxpayer under Section 166 on the theory that this was a revocable trust. The petitioner met this issue by showing that the trust was not revocable. It was not until after the decision in the *Clifford* case and the

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* See the following cases where the presence or absence of reserved powers of management and control were considered an essential element in the determination of the issues: *First National Bank* v. *Commissioner*, 110 F. (2d) 448 (C. C. A. 7); *Reuter* v. *Commissioner*, 118 F. (2d) 698 (C. C. A. 5); *Cox* v. *Commissioner*, 110 F. (2d) 934 (C. C. A. 10); *Jones* v. *Norris*, 122 F. (2d) 6 (C. C. A. 10), August 4, 1941; *Commissioner* v. *Branch*, 114 F. (2d) 985 (C. C. A. 1); *White* v. *Higgins*, 116 F. (2d) 312 (C. C. A. 1); *Whiteley* v. *Commissioner*, 120 F. (2d) 782 (C. C. A. 3), May 29, 1941. *Cf. Commissioner* v. *Brown*, (C. C. A. 3), September 4, 1941, not yet officially reported (reprinted in C. C. H. 1941 Federal Tax Service, Vol. 4, p. 10,569).

appeal to the Circuit Court of Appeals in the case at bar that petitioner could be expected to anticipate that Mrs. Carrere's relationship to the family group was of any importance whatsoever. On the basis of the facts before the Circuit Court of Appeals it would seem clear that Mrs. Carrere was not a member of such a family group as was involved in the *Clifford* and *Hormel* decisions.

The court further erred in failing to remand the entire case to the Board with directions to receive and consider testimony as to the applicability of Section 22 (a) to these trusts. The Commissioner in his brief before the court below stated that under the decision of this Court in *Hormel* v. *Helvering,* 312 U. S. 552, "a taxpayer should not be foreclosed from an opportunity 'to offer evidence before the Board on this issue, however remote may be his chance to take his case out of the Clifford rule' ", and stated that if the taxpayer so desires, he should be given an opportunity to present evidence on this issue before the Board. The petitioner urged upon the court below that a remand was not necessary for the reason that there was sufficient evidence in the record to justify an affirmance of the Board's decision, but pointed out that the necessity of remanding and ordering a new trial exists in cases where the record on appeal indicates presumptive liability of the taxpayer upon an issue not litigated before the Board, and where as a consequence it is necessary to *reverse* the Board. In the light of this position of both litigants and the explicit instructions as to appellate practice contained in *Hormel* v. *Helvering,* we submit that it was error to direct the Board merely to determine a tax deficiency in accordance with the views expressed in the Circuit Court opinion. (See also *Helvering* v. *Richter,* 312 U. S. 561.) This applies to the whole case, but it applies with particular force to the portion of the income payable to Mrs. Carrere, grantor's

mother-in-law, in view of the court's opinion that the burden was upon the taxpayer to show that she was not a part of the intimate family group. As pointed out above, the taxpayer was never confronted with that issue before the Board. The conflict between the Circuits resulting from the decision of the court below should be resolved by this Court.*

It may be pertinent to suggest that in taxing the income from these trusts to petitioner a certain inequity arises from the circumstance that petitioner, following a ruling of the Bureau of Internal Revenue that the creation of the trusts constituted a gift of a present interest to each donee

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* See *Commissioner* v. *Ward*, 119 F. (2d) 207, 208 (C. C. A. 3), April 1, 1941:

> "* * * since the Board is the tribunal charged with the duty of finding the facts and since it neither found the facts nor considered the applicability of section 22(a) in the light of the Clifford case, the cause is not ripe for decision in this court. Hormel v. Helvering, supra."

Commissioner v. *O'Keeffe*, 118 F. (2d) 639, 642 (C. C. A. 1), April 4, 1941:

> "* * * In view of Hormel v. Helvering, supra, * * * the thing for us to do is to remand the case to the Board for specific consideration of the applicability of §22(a), regard being had to the terms of the trust as a whole and to any additional evidence which either party may wish to introduce as bearing on this issue."

Crabb v. *Commissioner*, 121 F. (2d) 1015, 1016 (C. C. A. 5), July 25, 1941:

> "* * * The petitioners contend that the evidence was not fully developed bearing upon it. It is not plain to us what new evidence could be relevant, or how any different result could follow, but we will remand the case to the Board, as petitioners request, that full opportunity may be given to present their case." (Citing the *Hormel* and *Clifford* cases.)

See also: *Commissioner* v. *Central National Bank*, 119 F. (2d) 470 (C. C. A. 6), May 8, 1941; *Commissioner* v. *Brown* (C. C. A. 3), Sept. 4, 1941, not yet officially reported (reprinted C. C. H. 1941 Federal Tax Service, Vol. 4, p. 10,569).

of an amount equivalent to the value of the donee's interest for the life of the trust (and presumably in reliance thereon), made substantial accretions to one trust, extended the period of duration of both trusts and paid a substantial gift tax in respect thereof.

In the event that this petition for certiorari is granted and that the contentions of petitioner above set forth are sustained, petitioner reserves his contention, as made before the Board and the court below, that the amount of the insurance premium paid by Mrs. Barbour upon the policy on petitioner's life owned by her is not taxable income of petitioner under Section 167 of the Revenue Act of 1934.

Conclusion.

It is, therefore, respectfully submitted that this petition for a writ of certiorari should be granted.

November, 1941.

CHARLES S. MCVEIGH,
GEORGE M. WOLFSON,
Attorneys for Petitioner.